THE UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Power Exchange Corporation,	**Docket Nos. ER02-2234-010** **ER03-139-006** **ER03-791-003**

COMMENTS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR RESPONDING TO THE COMMISSION'S ORDER DATED AUGUST 6, 2004

Pursuant to the Commission's "Order Requesting Comments and Requiring Contingency Actions," issued August 6, 2004 ("Request for Comments"), the California Independent System Operator Corporation ("CAISO") respectfully provides the following Comments.[1]

Generally speaking, the CAISO would defer to the participants in the California Power Exchange ("PX" or "CalPX") who would fund any continued services by the PX on the question of whether continued reruns are necessary. The CAISO believes that PX participants perceive value in PX reruns, and hopes they will reach agreement as to how to allocate the cost of the PX reruns among themselves. The CAISO would not expect to object to any such agreement.

In the event that the PX participants are unable to devise an acceptable methodology for allocating the costs among themselves, there are two important factors that the Commission should bear in mind in fashioning a remedy: one of critical practical significance, the other with legal import.

[1] To the extent the Commission deems a motion to intervene to be necessary at this time, or in order to submit these comments, the CAISO hereby moves to intervene out-of-time. In light of the August 6, 2004 Order, good cause exists to grant this motion to intervene due to the fact that the order contemplates the possibility that PX assets and responsibilities might be transferred to the CAISO.

First, the CAISO has concerns about the Commission's direction to the PX to prepare for a possible transfer of assets and records to the CAISO "or some other appropriate entity." A transfer of PX assets or responsibilities to the CAISO would not resolve the problem of funding, even assuming it were legally possible and approved by the CAISO Board of Governors (and Board approval would be necessary as the Federal Power Act does not grant the Commission authority to impose PX assets and responsibilities on the CAISO over its objection). At the same time, it would be extremely burdensome and disruptive to the CAISO, and could undermine the CAISO functions. These problems underscore the importance of reaching agreement on a means of funding the PX, or else to identify another "appropriate entity" to take custody of the PX's assets and responsibilities.

Second, there is no legal basis for PX wind-up costs to be assessed to the CAISO because the CAISO is not now, and never has been, a customer of the PX, and the PX has never provided service to the CAISO. The CAISO does not believe that the Commission should feel compelled to reach a contrary conclusion by the July 9, 2004 opinion of the United States Court of Appeals for the District of Columbia Circuit (the "Court") in *Pacific Gas & Electric Co. v FERC*, Case 03-1025 et al. ("July 9 Opinion") to assess PX costs to the CAISO. The language in Section C of the July 9 Opinion regarding "CAISO Account Balances" should be applied, if at all, by assessments to PX participants based on their account balances in CAISO markets. It cannot reasonably be understood to bind the Commission to assess the CAISO, for pass-through to its markets, because the Court's discussion was *dicta* that went beyond the arguments and issues before the Court, as well as the FERC proceeding under review.

I. A Transfer of PX Assets to the CAISO, Even Assuming it were Legally Possible and Approved by the CAISO Board of Governors, Would Complicate Funding Issues Rather than Resolve Them

On the possibility that participants will not fund necessary services of the PX, the Request for Comment instructs the PX to prepare for "transfer" of assets, records and unspecified "other materials" to the CAISO "or some other appropriate entity." A transfer to the CAISO would be extremely burdensome and disruptive and could raise obstacles that go to the core of the CAISO's functioning. Before CAISO's Board of Governors could even consider such a possibility – and its prior approval would be required[2] – a number of difficulties would need to be resolved. In addition to the complex legal arrangements that would be necessary for any entity to assume PX responsibilities – modifications of Tariffs, contracts, insurance, etc. – a transfer to the CAISO would face unique obstacles, including but not limited to the following:

- *Preservation of the CAISO's 501(c)(3) Status and Debt Financing*. The CAISO's Articles of Incorporation require that it maintain tax exempt status within section 501(c)(3), and expressly proscribe "any activities not permitted to be carried on . . . by a corporation exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code."[3] Significantly, the PX did not qualify for 501(c)(3) status.

  In addition, any loss of 501(c)(3) status could jeopardize the CAISO's financing. Maintenance of 501(c)(3) status is a condition of the tax-exempt bonds that financed the CAISO's startup capital costs.

  The CAISO is advised by bond counsel that, before accepting new types of assets or, more significantly, responsibilities, the CAISO should confirm with the Internal Revenue Service that its 501(c)(3) status would not be jeopardized. Given that the CalPX itself did not qualify for 501(c)(3) status, approval from the

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[2] Nothing in the Federal Power Act grants the Commission authority to order the CAISO to assume involuntarily the responsibilities of the PX

[3] The CAISO's Articles of Incorporation are available on line at http://www.caiso.com/docs/1998/11/06/1998110614383910292.pdf.

IRS would by no means be a formality. This process could require several months.

- *CAISO Rate Funding*. A transfer of PX responsibilities to the CAISO would not resolve problem of funding, and only impose additional problems and expenses on California's ongoing electricity markets.

  At a very minimum, the CAISO would be required to duplicate the PX, because PX systems are not compatible with CAISO hardware, software or processes. CAISO settlements resources, moreover, are fully utilized in reruns and market redesign, which are above and beyond daily settlement responsibilities. The transfer itself, let alone custody of PX records, would impose massive legal expenses on the CAISO.

  At the same time, CAISO is in no better position to resolve the rate problem which, by hypothesis, could not be resolved in this docket. The additional expenses of the PX reruns could upset the three year settlement of the CAISO's Grid Management Charge, filed on July 29, 2004, by causing it to exceed the specified revenue requirement caps for 2005 and 2006.

- *Legal Arrangements to Avoid Risk of Successor Status*. A transfer of the PX's assets and responsibilities would run the risk that the recipient would be found to be the successor to the PX. Were that to be the CAISO, it would be placed in hopeless legal conflicts in active litigation and under its own Tariff. The jurisdiction of the bankruptcy court presumably would follow.

For all of these reasons, the cost of the CAISO conducting PX reruns would likely exceed the costs of the PX doing the work itself. Under the circumstances, it is not apparent why any entity would prefer a transfer of PX assets to the CAISO over utilization of the funding mechanism provided in the PX's confirmed plan of reorganization. See § III.D.4.b ("In the event that it becomes apparent that the Reorganized Debtor Expense Reserve will be exhausted, the Reorganized Debtor may seek approval from FERC to obtain additional funds from the Settlement Clearing Account."). This mechanism seems to permit the Commission to address any participant concerns about PX expenditures, as it authorizes the Commission to require

a showing of need for specific budget items, and impose other appropriate conditions on the funding.

These considerations underscore the need for PX participants to reach agreement on means of funding the reruns and distribution, or at least to identify a different "appropriate entity" to which the PX's assets could be transferred.

II. PX Costs Should not be Assessed to the CAISO

There is no legal basis for PX wind-up costs to be assessed to the CAISO because the CAISO is not now, and never has been, a customer of the PX, and the PX has never provided service to the CAISO. The CAISO was not a party to a Participation Agreement with the PX, or any other agreement under which the PX could assess charges to the CAISO. The only legal relationship between the PX and the CAISO arose from the PX's status as a CAISO Scheduling Coordinator. Neither the CAISO Tariff nor the Scheduling Coordinator Agreement provides any basis for assessing charges against the CAISO.

Nothing in the July 9 Opinion requires otherwise. In sections A and B of the July 9 Opinion, the Court concluded that the allocation based on account balances employed by the Commission was impermissible. Section C went on to volunteer guidance about CAISO account balances "to the extent that using outstanding account balances would be appropriate." In short, Section C is unnecessary *dicta* that would not bind the Court were the matter presented to it again. In evaluating funding mechanisms for the PX, the Commission should evaluate the Court's discussion critically, and not consider itself bound by the questionable or unsupported implication thereof.

Thus, while the July 9 Opinion states that the Commission does not explain why the CAISO should not be required to pass through assessments based on "CAISO Account Balance," it does not impose any such requirement. The July 9 Opinion is properly understood only to require that assessments to PX participants should consider their respective balances in CAISO markets. It cannot reasonably be understood to require the Commission to assess the CAISO for pass-through to its markets.

Although the July 9 Opinion, section C, discusses assessments to CAISO as a pass-through, the discussion is premised on erroneous assumptions that went beyond both the arguments and the record. In particular, the Court assumed that the CAISO was a "customer" of the PX. As the Commission is well aware, this is not correct, and there was no record evidence on the point. Rather, the statement apparently was a misreading of a statement in PG&E's Reply Brief that [t]he majority of sales into [CalPX] were sold to [CalPX] by [the CAISO]" and "[the CAISO] was the largest seller into CalPX." PG&E Reply Br. at 12. There can be no dispute that CAISO did not, and was not authorized to, enter transactions in the markets operated by PX. The PX (as a CAISO Scheduling Coordinator and signatory to the CAISO Tariff) bought and sold into the CAISO markets, not vice-versa. Simply put, the ISO was never a customer of PX.[4] The Commission should not build upon this misunderstanding of the court by relying upon Section C any more than is compelled by the legal logic of the opinion. This is

[4] Thus, the entire discussion of the CAISO balance went beyond the scope of the proceedings under review, which were noticed as assessments to PX participants. *See* 67 Fed. Reg. 46,650 (July 16, 2002) ("Take notice that on July 3, 2002, the California Power Exchange Corporation (CalPX) tendered for filing a proposed Rate Schedule FERC No. 1. The purpose of the rate schedule is to enable CalPX to recover from *its participants* its costs and expenses for winding up its business from July 1, 2002 through December 31, 2004. CalPX proposes to assess charges to *its participants* semi-annually based on the amount an *individual participant* owes CalPX or is owed by CalPX . . . ."; emphasis added).

especially the case given that the PX has never rendered jurisdictional service for the CAISO, and the CAISO does not have a service agreement with the PX. Accordingly, there is no legal basis for the Commission to assess the CAISO for PX wind-up charges.

To the extent that the Commission does not rely on the erroneous assumption that the CAISO itself was a PX customer, the Commission can act consistently with the Court's reasoning without assessing the CAISO for PX wind-up charges even if the Commission employs some form of account balance methodology. The CAISO balance is for costs assessed to the PX as SC for entities that scheduled and participated in CAISO markets. If costs were assessed to the CAISO, the only reasonable thing for the CAISO to do would be to pass those costs through just to the PX itself, for further allocation by the PX to those for whom it acted as Schedule Coordinator in the CAISO markets. This, of course, would complicate matters due to the need for an ISO Tariff filing and the status of the PX. So, the efficient way to do it is for the PX to assess those PX Participants directly as part of its filing, based on their respective responsibilities for the PX balances as Schedule Coordinator in the CAISO markets.

III. Conclusion

The CAISO thanks the Commission for the opportunity to provide these comments, and respectfully requests that the Commission adopt an order consistent therewith.

Respectfully submitted,

/s Daniel J. Shonkwiler

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Dated: August 16, 2004

CALIFORNIA ISO

California Independent
System Operator

August 16, 2004

The Honorable Magalie Roman Salas
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

Re: California Power Exchange Corporation
Docket Nos. ER02-2234-010, ER03-139-006 and ER03-791-003

Dear Secretary Salas:

Enclosed please find an electronic filing of the Comments of the California Independent System Operator Corporation Responding to The Commission's Order Dated August 6, 2004. Thank you for your attention to this filing.

Respectfully submitted,

/s Daniel J. Shonkwiler
Daniel J. Shonkwiler

Counsel for the California Independent
System Operator Corporation

CERTIFICATE OF SERVICE

I hereby certify that I have this day electronically served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Folsom, CA, this 16th day of August 2004.

/s Daniel J. Shonkwiler
Daniel J. Shonkwiler